IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 5 of 1990

For Approval and Signature:

Hon'ble MR.JUSTICE A.R.DAVE
and
Hon'ble MR.JUSTICE A.M.KAPADIA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF INCOME-TAX

Versus

GUJARAT ALUMINIUM EXTRUSIONS PVT LTD.

Appearance:

1. INCOME TAX REFERENCE No. 5 of 1990
MR DD VYAS STANDING COUNSEL for M/S. VYAS ASSOCIATES for Petitioner No. 1
MR TUSHAR HEMANI for Respondent No. 1

CORAM : MR.JUSTICE A.R.DAVE
and
MR.JUSTICE A.M.KAPADIA

Date of decision: 02/07/2003

ORAL JUDGEMENT

(Per : MR.JUSTICE A.R.DAVE)

1. At the instance of the revenue, the following question has been referred to this Court under the provisions of Section 256 (1) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'):

"Whether, on the facts and in the circumstances of the case and in law, the Tribunal is right in holding that deduction u/s.35 (2) is allowable on capital expenditure for building which is under construction and is not put to use for research and development purpose?"

2. We have heard Senior Advocate Shri D.D. Vyas, Standing counsel for the applicant - revenue and learned Advocate Shri Tushar Hemani for the respondent - assessee.

3. The facts giving rise to this reference, in a nutshell, are as under:

3.1. The assessee is a Private Limited Company manufacturing Aluminium extruded sections. The assessee constructed a building for the purpose of scientific research and, therefore, claimed deduction under the provisions of Section 35 (1) (iv) read with Section 35 (2) of the Act for the assessment years 1981-82 and 1982-83. It is not in dispute that construction of the building was completed on 25.10.1981 as per the certificate given by the concerned architect.

3.2. The assessee claimed the deduction under the provisions of Section 35 of the Act but as construction of the building was not over and as the building was not put to use in the said assessment years, the Income Tax Officer did not allow the deduction claimed by the assessee.

3.3. Being aggrieved by the disallowance, the assessee filed an appeal before the Commissioner of Income-Tax (Appeals). The Commissioner of Income-tax allowed the appeal holding that it was not necessary for the assessee to put the said building to use so as to avail the deduction under the provisions of section 35 of the Act.

3.4. Being aggrieved by the order passed by the Commissioner of Income-tax (Appeals), the revenue filed

an appeal before the Tribunal. The Tribunal agreed with the view expressed by the Commissioner of Income tax (Appeals) and dismissed the appeal.

4. In the circumstances referred to hereinabove, the question which this court has to decide is whether the assessee can avail deduction under the provisions of Section 35 of the Act even if the assessee does not use the building for scientific research.

5. The standing counsel appearing for the revenue has submitted that as the building was not put to use for research and development by the assessee during the assessment years in question, the assessee was not entitled to the deduction under the provisions of Section 35 of the Act. According to him, the assessing officer was absolutely right when he disallowed the claim made by the assessee. As per his submission, the Commissioner of Income Tax (Appeals) as well as the Tribunal erred in law by allowing the deduction claimed by the assessee under the provisions of Section 35 of the Act.

6. Relevant portion of Section 35, which was in force at the relevant time, is as under:

S.35. (1) Expenditure on scientific research.--
In respect of expenditure on scientific research, the following deductions shall be allowed--
(i) xxxxx
(ii) xxxxx
(iii) xxxxx
(iv) in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible under the provisions of sub-section (2).

(2) For the purposes of clause (iv) of sub-section (1)--
(i) xxxxx
(ia) in a case where such capital expenditure is incurred after the 31st day of March, 1967, the whole of such capital expenditure incurred in any previous year shall be deducted for that previous year:

Explanation: Where any capital expenditure has been incurred before the commencement of the business, the aggregate of the expenditure so incurred within the three years immediately

preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced."

7. The standing counsel for the revenue has submitted that though the assessee had incurred capital expenditure, the assessee could have claimed the deduction only if the assessee had used the building for the purpose of scientific research.

8. It has been submitted by him that the purpose behind allowing the deduction is to encourage research and development activity. According to him, the revenue has enacted Section 35 so as to give an incentive to assessees so that they initiate research and development activities which are ultimately beneficial to the society. According to him, if the building which has been constructed by the assessee is in fact not used for the purpose of research and development, the purpose with which the said section is enacted would be frustrated. He has submitted that so as to avail the deduction under the provisions of Section 35 of the Act, the assessee must establish the following two facts:

(i) the asset must be acquired during the relevant previous year, and

(ii) the asset must be used for research and development purpose.

9. He has fairly submitted that section 35 of the Act nowhere makes it obligatory on the part of the assessee to use the asset for the purpose of scientific research to avail the deduction. However, he has submitted that looking to the object with which the Section has been enacted, one has to interpret the section in such a way that if the asset is not put to use for research and development, the assessee does not get the benefit of deduction under the provisions of Section 35 of the Act.

10. It has been further submitted by the learned standing counsel that both the appellate authorities erred while not considering the aforestated relevant facts. It has been also submitted by him that the Tribunal materially erred in law in allowing the deduction even though the construction of the building was not over in one of the assessment years. According to him, if the construction of the building was not over, the building could not have been used for research and development. The said important factor was lost sight of by the Tribunal and, therefore, according to him, the orders passed by both the appellate authorities are not

just and proper. In these circumstances, it has been submitted by the standing counsel for the revenue that the question referred to this Court deserves to be answered in favour of the revenue.

11. On the other hand, learned advocate Shri Tushar Hemani appearing for the assessee has submitted that both the appellate authorities were justified in setting aside the order passed by the Income Tax Officer as the assessee was entitled to the deduction as per the provisions of section 35 of the Act.

12. So as to substantiate his submission, the learned advocate for the assessee has submitted that looking to the language employed in section 35 of the Act, to avail the deduction, the assessee has to incur expenditure. If the expenditure is of a capital nature, the assessee becomes entitled to claim the deduction under the provisions of Section 35 (1) (iv) read with section 35 (2) (ia) of the Act.

13. It has been submitted by him that upon perusal of the relevant provisions, it is crystal clear that the legislature does not expect the assessee to use the asset for research and development purpose during the relevant previous year. According to him, if any expenditure is incurred during the previous year, the assessee becomes entitled to the deduction even if the asset in question is not actually used. He has relied upon the judgments delivered in the cases of:

1) Commissioner of Income-Tax v. H.M.T. Limited, 199 ITR 235
2) Ravi Machine Tools (P.) Ltd. v. Commissioner of Income-Tax, 114 ITR 459
3) Commissioner of Income-Tax v. HMT Limited (No.1), 203 ITR 811.

14. He has mainly relied upon the judgment delivered in the case of Commissioner of Income-Tax v. H.M.T. Limited (No.1), 203 ITR 811. It has been submitted by him that in the said case a similar issue had arisen and the Karnataka High Court held that the amount spent by the assessee towards the value of work-in-progress, machinery and equipment in transit and under erection at the assessee's research and development division would be eligible for deduction under section 35 of the Act. He has submitted that the Karnataka High Court, while delivering the said judgment, had relied upon the ratio of the judgment delivered by the same High Court in the case of Ravi Machine Tools (P.) Ltd., v. Commissioner of

Income Tax, 114 ITR 459. It has been fairly submitted by him that the said judgment pertains to interpretation of the provisions of Section 80J of the Act. However, his endeavour is to show that when the words "actual use" are not used in the section, the revenue cannot read those words in the section so as to deprive the assessee of the advantage which the legislature wants to give to the assessee. According to him, benefit under section 80J was directed to be given to the concerned assessee in the judgment delivered in the case of Ravi Machine Tools (P.) Ltd. v. Commissioner of Income-Tax, 114 ITR 459 though the capital which was employed by the assessee had not been actually used during the relevant previous year. Using the said analogy in the instant case, it has been submitted by the learned advocate that as the provisions of Section 35 of the Act do not make it obligatory on the part of the assessee to use the asset for research and development, the revenue cannot expect the assessee to use the said asset during the relevant previous year for research and development purpose so as to avail the deduction under the said Section.

15. We have heard the learned advocates at length and have considered the judgments cited before this Court.

16. The object behind the enactment of section 35 of the Act is to encourage research and development activities by the assessee. As an incentive, the legislature has given this benefit by way of deduction in respect of the capital expenditure incurred by the assessee. This is a provision for the benefit of the assessee and if the assessee incurs capital expenditure for the purpose of research and development during the relevant previous year, in our opinion, the revenue should not deprive the assessee of the benefit of deduction under the provisions of section 35 of the Act even if the asset is not put to use for research and development. It is a settled legal position that the provision for exemption or relief should be construed liberally and in favour of the assessee. If the section is interpreted in the manner suggested by the standing counsel for the revenue, in our opinion, we would be depriving the assessee of the benefit which legislature desires to give to the assessee.

17. It is also pertinent to refer to Circular No.5-P (LXXVI-63) of 1967 dated 9th October, 1967 issued by the department. The relevant extract of the said circular reads as under:

"..........
(ii) The amount of capital expenditure incurred by an assessee after March 31, 1967, on scientific research related to his business will be allowed to be deducted in full in computing his business profits of the year in which such expenditure is incurred."

18. From the provisions of the above referred to Circular also, intention of the revenue is patent. The intention is to give benefit to the assessee who incurs expenditure on scientific research related to his business. Even the circular issued by the department does not make use of the capital asset a condition precedent for claiming deduction under the provisions of Section 35 of the Act.

19. In our opinion, both the appellate authorities have rightly considered the spirit with which Section 35 of the Act has been enacted by the legislature and the circular referred to hereinabove while allowing deduction to the assessee under the provisions of Section 35 of the Act.

20. We are of the view that when the legislature has not expected the assessee to put the asset to actual use, it would not be open to the revenue to deprive the assessee of the benefit of deduction under the provisions of section 35 of the Act if the asset is not used in the previous year in which the capital expenditure is incurred.

21. It is also relevant to note that the deduction is given not on the count of user. Had it been so, the assessee would have been given benefit in the nature of depreciation. It cannot be disputed that depreciation is allowed when the asset is used by the assessee and when he suffers loss on account of wear and tear of the asset. Had the intention of the legislature been to grant additional depreciation, we would have agreed with the submissions made by the standing counsel appearing for the revenue but the position is different in the instant case. Here, the legislature wants the assessee to spend more amount for scientific research and it also wants the assessee to get the benefit immediately in the year in which he incurs the expenditure in the nature of revenue or capital for scientific research and therefore the legislature refers to incurring of the expenditure and not the using of the asset.

22. Once it is established that the expenditure was incurred for the purpose of scientific research and the conditions incorporated in Section 35 of the Act are fulfilled, in our opinion, the revenue cannot expect the assessee to start using the asset immediately. In a given case the assessee might have to go on incurring expenditure for several years before putting the asset to actual use. If the interpretation advanced by the standing counsel for the revenue is accepted, we are afraid, the assessee would not be in a position to avail the deduction under Section 35 of the Act to the extent to which the legislature intends to give to the assessee.

23. It is also pertinent to note that the deduction under the provisions of section 35 of the Act is given only during the previous year in which the expenditure is incurred. If the assessee has taken several years to construct or acquire a particular asset, the assessee would be deprived of the benefit of section 35 of the Act because he can put the asset to use only when construction of the asset is completed and it would not be open to him to claim deduction in respect of expenditure incurred during the earlier previous years because looking to the provisions of Section 35 of the Act, the assessee can avail the benefit of deduction of the amount of expenditure incurred only during the previous year and not for the earlier period unless his case is covered under the provisions of an exception to section 35 (2) (ia) of the Act.

24. For the reasons stated hereinabove, in our opinion, the Tribunal was right when it confirmed the order passed by the Commissioner of Income Tax (Appeals) who had deleted the disallowance.

25. For the aforestated reasons, we answer the question in the affirmative, i.e., in favour of the assessee and against the revenue.

26. The reference stands disposed of with no order as to costs.

(A.R. Dave, J.)

(A.M. Kapadia, J.)

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